

International Commercial Transactions, Franchising, and Distribution

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This article highlights certain developments in the law of franchising and distribution that occurred during late 2012 and 2013.

I. Restrictions on Internet Sales of Branded Products in the European Community

Internet sales of branded products not only give consumers a convenient method of shopping, but also facilitate price shopping. Generally, B2C Internet platforms offer lower prices than conventional “brick and mortar” retail stores. This price difference has

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led to explosive growth of this distribution channel in Europe. The United Kingdom has the highest Internet sales per capita in the world, and other countries in the European Community are high up on the list.¹ This has put pressure on traditional retailers, who have pressured manufacturers to take action to get branded products off the Internet. Such actions against traditional price cutters have been regarded as an antitrust violation under Article 101 of the EU Treaty.²

Prior to the European Court of Justice's (ECJ) decision in *Pierre Fabre*, many companies justified prohibitions on Internet sales of branded products as a legitimate restriction to protect an exclusive brand and to prevent e-tailers (Internet sellers) from free-riding off the investment of traditional retailers in physical display of products and in salespeople whom customers may want to see or consult before buying from an e-tailer. The ECJ expressly rejected that defense; companies concerned with freeriding were called on to take less restrictive measures to assure adequate brand representation.³

Two years later, there has been a strong reaction in the market for branded products as well as enforcement efforts by the Commission and the national competition authorities.

Most high-end European luxury goods manufacturers (e.g., Prada, Gucci, Hermes, or Louis Vuitton) offer their branded goods on the Internet in a web shop.⁴ Others, like Burberry, do not sell directly to consumers and refrain from competing with their own dealers, though their dealers sell on the Internet and compete with each other.⁵

There remains a number of controversial issues surrounding the restrictions. In July 2013, the German *Bundeskartellamt*, the Federal Cartel Office, issued a statement of objections against an Internet hotel reservations portal with a high market share called HRS. HRS enforced what is known as an "English" clause or "Best Price" clause in its vendor contracts. Under the "English" clause, hotels offering reservations through HRS were prohibited from booking rooms at a lower price for customers who contacted the hotel directly for a reservation. The *Bundeskartellamt* objected to enforcement of HRS's "English" clause as an anti-competitive practice, calling into question the practice of many major e-commerce merchants of including "English" clauses in their supply agreements.⁶

Conversely, some manufacturers are imposing restrictions on their dealers on selling through third-party websites such as eBay and Amazon, which are thought to be aggressive price-cutters. This practice is coming under fire by competition authorities. Enforcement activity against restrictions on Internet selling by manufacturers trying to combat price cutting is ongoing in several EU States—including, especially, the Office of

1. *UK Ranked as World's Most Developed Online Retail Market*, CUSHMAN & WAKEFIELD (July 1, 2013), <http://www.cushmanwakefield.com/en/news/2013/07/uk-ranked-as-worlds-most-developed-online-retail-market/>.

2. Consolidated Version of the Treaty on the Functioning of the European Union art. 101, May 9, 2008, 2008 O.J. (C 115) 88.

3. Case C-439/09, *Pierre Fabre Dermo-Cosmétique SAS v. Président de l'Autorité de la concurrence*, 2011 E.C.R. I-9447.

4. See, e.g., *Prada E-Store*, PRADA, <http://store.prada.com/en/US> (last visited Feb. 19, 2014).

5. See BURBERRY, burberry.com (last visited Feb. 19, 2014) (displaying "collect in store").

6. See Press Release, *Bundeskartellamt, Bundeskartellamt Continues to View HRS's Best Price Clause Critically* (July 25, 2013), available at http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemittellungen/2013/25_07_2013_HRS.html.

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Fair Trading (OFT) in the United Kingdom⁷ and the *Bundeskartellamt*⁸ in Germany, the two biggest Internet markets in Europe. Joaquín Almunia, the Commissioner of the European Union responsible for competition, has emphasized in 2013 that actively furthering and promoting e-commerce will continue to be an enforcement priority.⁹

Accordingly, manufacturers of branded products with legitimate concerns as to the freeriding of European Internet sales platforms off their traditional European dealer base need to take a much more proactive and differentiated approach to e-commerce than a simple prohibition. This might include requirements as to the quality of presentation of the products on the websites, requirements of a certain amount of traditional retail sales by e-tailers, or even cross-subsidies to retailers with physical stores and displays, where these actually support e-commerce sales.

II. Recent Developments in South Korean Franchise Laws

A. AMENDMENTS TO FAIR TRANSACTIONS IN FRANCHISE BUSINESS ACT AND ENFORCEMENT DECREE

In July 2013, as part of the government's measures to promote "economic democracy," the South Korean National Assembly passed an amendment (Amendment) to the Act on Fair Transactions in Franchise Business (Franchise Act). The Amendment will become effective on February 14, 2014. The major purposes of the Amendment are (i) to strengthen the rights of franchisees, (ii) to remedy unfair practices of franchisors, and (iii) to strengthen the obligation to provide information.¹⁰ The key aspects of the Amendment are detailed below.

In November 2013, the Korea Fair Trade Commission (KFTC) introduced a draft amendment to the Enforcement Decree of the Franchise Act, the Presidential Decree implementing the Franchise Act, which includes details on how to implement the Amendment. The amendment to the Enforcement Decree will have the status of a binding regulation when it becomes effective.¹¹

7. See Press Release, Office of Fair Trading, OFT Issues Statement of Objections in Mobility Scooters Sector (Sept. 24, 2013), *available at* <http://www.oft.gov.uk/news-and-updates/press/2013/66-13#.UwQr3v1AiQY>; Press Release, Office of Fair Trading, OFT Issues Statement of Objections to Sports Bra Supplier and Three UK Department Stores (Sept. 20, 2013), *available at* http://www.oft.gov.uk/news-and-updates/press/2013/64-13#.UwQr__1AiQY.

8. See Press Release, Bundeskartellamt, Vertical Restraints in the Internet Economy Meeting of the Working Group on Competition Law in Bonn (Oct. 14, 2013), *available at* http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/14_10_2013_Proftagung.html.

9. Joaquín Almunia, Vice President, Eur. Comm'n responsible for Competition Policy, Address at ECR Europe Annual Conference: Consumer-Goods Markets: A Litmus Test for Competition Policy (May 14, 2013), *available at* http://europa.eu/rapid/press-release_SPEECH-13-410_en.htm.

10. Peulaenchaijeu sa-eob beob [Franchise Business Act], Act. No. 6704, May 13, 2002, *amended by* Act. No. 12094, Feb. 14, 2014 (S. Kor.).

11. Peulaenchaijeu sa-eob beob sihaenglyeong [Enforcement Decree of Franchise Business Act], Presidential Decree No. 25050, Dec. 30, 2013, *as amended* (S. Kor.).

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B. EXTENDED PROHIBITION OF UNFAIR TRANSACTIONS BY FRANCHISOR

The Amendment added a new provision, in Article 12-2, prohibiting a franchisor from imposing store environment improvement costs on its franchisees without justifiable reasons. Under the new provision, a franchisee will bear the cost of store environment improvements at a rate determined by Presidential Decree,¹² to the extent such rate is less than 40 percent; provided, however, that if a franchisee has to improve its store environment due to sanitation or safety concerns resulting from works voluntarily performed by the franchisee or otherwise attributable to the franchisee, without the franchisor's request, or due to objective deterioration in the store, the franchisor is not required to bear the cost.¹³

The Amendment, in Article 12-3, prohibits the practice by certain franchisors of unfairly restricting the franchisees' business hours. Thus, it shall be deemed an unfair restriction of business hours if the franchisor does not permit a franchisee to reduce its business hours, (i) even though such franchisee has suffered losses due to its operation during night hours, as the relevant sales are lower than the cost, or (ii) even though such franchisee requests a reduction in business hours due to unavoidable circumstances, such as disease or treatment of disease.¹⁴

Before the Amendment, there was no provision requiring the franchisor to define a business area. The amended Franchise Act, in Article 12-4, now provides that, when executing an agreement, the franchisor is obligated to define and stipulate the business area for a franchisee in the agreement. Further, the franchisor is not permitted to set up another franchise or any shop of the same trade or otherwise directly operated by the franchisor in the same business area without justifiable reasons; provided, however, that in the event of any cause stipulated by Presidential Decree, the business area may be reasonably adjusted through consultation between the franchisor and the franchisee at the time the relevant franchise agreement is renewed. This new provision is now scheduled to become effective on August 14, 2014.¹⁵

C. INCREASE IN FRANCHISOR'S OBLIGATION TO PROVIDE INFORMATION

The Amendment contains new provisions that require franchisors to provide written materials on expected future sales. Under the pre-amendment Franchise Act, franchisors were required to allow franchisees or potential franchisees to access information related to sales forecast only at their request. But under the Amendment and the draft amendment to the Enforcement Decree, once they enter into force in February 2014, all franchisors over a certain size (i.e., the franchisor is not a small or medium-sized company or there are more than one hundred franchise stores) will have to provide potential franchisees with

12. The draft amendment to the Enforcement Decree of the Franchise Act provides that, (i) in case of store environment improvement that requires moving and expansion, the rate will be 40 percent, and, (ii) in case of store environment improvement that does not require moving and expansion, the rate will be 20 percent.

13. Peulaenchaijeu sa-eob beob [Franchise Business Act], Act. No. 12094, Feb. 14, 2014, art. 12-2 (S. Kor.).

14. *Id.* art. 12-3.

15. *Id.* art. 12-4.

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the scope of estimated sales¹⁶ and the relevant basis of calculation at the time of execution of a franchise agreement, and shall maintain such information for five years from the date of execution of the franchise agreement.¹⁷

In addition, the Amendment requires franchisors to provide the Information Disclosure Statement by content-certified mail or by other means, such as electronic mail with automatic receipt notification,¹⁸ prescribed by Presidential Decree, from which the date of provision of information can be identified. The Amendment strengthens the overall disclosure obligations by (i) requiring franchisors to specify whether they have violated the Act on General Terms and Conditions and to specify information on franchisor's assistance for the management and sale activities of franchisees in disclosure documents, and (ii) increasing the amount of the fine in case of provision of false or exaggerated information.¹⁹

**D. MEASURE TO STRENGTHEN PROTECTION OF FRANCHISEE'S RIGHTS AND
NEGOTIATION LEVERAGE**

The Amendment permits franchisees to form an organization to protect their rights and advance their economic status. The Amendment grants a franchisee organization, composed of franchisees using the same trademarks, the right to request consultation on transaction terms, including modification of a franchise agreement with the franchisor, while obligating the franchisor to respond in good faith to such request. Meanwhile, under the Amendment, the franchisor shall not penalize franchisees on the grounds that they have formed, have been admitted to, or have been involved in the activity of a franchisee organization. In the event of violation of the foregoing, the franchisor may be subject to corrective measures or a fine.²⁰

E. OTHER PROVISIONS: REPEAL OF EXCLUSIVE RIGHT OF COMPLAINT

Under the pre-Amendment Franchise Act, certain criminal violations of the Franchise Act could be prosecuted only when the KFTC had filed a complaint and the Prosecutor General had the exclusive right to request the KFTC to file such complaint. The Amendment, however, grants such right to the Chairman of the Board of Audit and Inspection (a governmental watchdog) and to the head of the Small and Medium Business Administration (a quasi-governmental body in charge of promoting SMEs). When so requested, the KFTC is required to file a criminal complaint.²¹

16. In relation to the scope of expected future sales of the prospective franchisee's store for one year from the commencement of the business by the prospective franchisee, the maximum amount of the expected future sales must not exceed 1.3 times the minimum amount of the expected future sales.

17. Act. No. 12094 art. 9(5); Peulaenchajjeu sa-eob beob sihaenglyeong [Enforcement Decree of Franchise Business Act], Presidential Decree No. 25050, Dec. 30, 2013, art. 9, *as amended* (S. Kor.).

18. Disclosure documents may be delivered personally only if an acknowledgment of receipt written in the prospective franchisee's own handwriting is provided.

19. Peulaenchajjeu sa-eob beob [Franchise Business Act], Act. No. 12094, Feb. 14, 2014, art. 2 (S. Kor.).

20. *Id.* arts. 14-2, 33, 35.

21. *Id.* art. 44.

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F. THE KFTC FORM FRANCHISE AGREEMENT AS A SOURCE OF BEST PRACTICES

Apart from the Amendment and the draft amendment to the Enforcement Decree, other recent changes have taken the form of a non-binding statement of best practices. The KFTC has issued a form franchise agreement containing best practices, which has been conformed to reflect the recent changes. It has established these best practices in response to a recent increase in disputes between franchisors and franchisees resulting from the rapid growth of franchises in various businesses (e.g., bakeries, confectioneries, fast food restaurants, coffee shops, and convenience stores).

For example, the KFTC's form franchise agreement sets standards for the distance between the newly launched franchise stores and existing franchise stores, the period within which a franchise store must be renovated, and the party who must bear the expenses relating to such renovation.

Although use of the form franchise agreement is not mandatory, the KFTC has encouraged the parties to follow its standards in their franchise agreements and in the Information Disclosure Statements provided by franchisors.

III. Australian Franchising Code: Proposed Amendments

A. OVERVIEW

In 2013, the Commonwealth of Australia's Government carried out a number of initiatives to review, and possibly change, the Australia Franchising Code of Conduct (Franchising Code) in order to improve the regulatory regime for franchising in Australia.

The 2013 proposed changes were aimed primarily to (i) build on an otherwise effective disclosure regime by ensuring that future disclosure would be relevant, timely, effective, and reflect modern changes in the Australian economy; (ii) clarify that the Government expects franchisors and franchisees to act in "good faith" toward one another; (iii) enhance compliance and enforcement of the Franchising Code by providing additional tools to the Commonwealth regulator, the Australian Competition and Consumer Commission (ACCC); and (iv) clarify the policy intent of certain provisions of the Franchising Code that have previously caused unintentional confusion or an administrative burden without any corresponding benefit.²²

The proposed changes, once legislated, will represent the largest overhaul of the Franchising Code since its inception and should strengthen the uniform national framework for the regulation of franchising, which has been under attack from certain state legislatures in recent years. Generally, the changes improve the administrative burden on franchisors, although the strengthening of the enforcement regime represents increased exposure for franchisors.

22. See generally GOV'T OF AUSTL., FORWARD LOOKING FRANCHISING REGULATION: COMMONWEALTH GOVERNMENT RESPONSE TO THE REVIEW OF THE FRANCHISING CODE OF CONDUCT (July 2013), available at <http://www.innovation.gov.au/smallbusiness/codesofconduct/Documents/GovernmentResponseToFranchisingCodereview.pdf>.

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B. BACKGROUND

The Franchising Code has been reviewed several times since it was first introduced in 1998. It was most recently amended in 2008, and then again in 2010. The 2008 amendments were designed primarily to promote disclosure between franchisors and current or prospective franchisees and to increase the transparency, quality, and timeliness of disclosure by franchisors.²³ The 2010 amendments primarily dealt with end-of-term arrangements, disclosure of additional information by franchisors, behavior by franchisors and franchisees in the dispute resolution process, and good faith.²⁴

As part of the Australian Government's continued efforts to improve and monitor franchise regulation in Australia, it undertook to review, in 2013, the efficacy of the 2008 and 2010 amendments to the Franchising Code.

In January 2013, the Australian Government announced that the review of the Franchising Code would be conducted by Mr. Alan Wein. Public submissions were also sought as part of the review, and, by mid-February 2013, seventy-three submissions were received. Mr. Wein presented his review report to the Australian Government on April 30, 2013 (Review Report), which was made publicly available on May 17, 2013. The Review Report resulted in eighteen recommended changes to the Franchising Code dealing with disclosure, good faith, dispute resolution, and the introduction of fines and penalties.²⁵

On June 17, 2013, the Government released an industry consultation paper to seek input on options that could be implemented in response to the recommendations contained in the Review Report. The Government announced its response to the Review Report on July 24, 2013, which contained eighteen recommended amendments to the Franchising Code dealing with disclosure, good faith, dispute resolution, and the introduction of fines and penalties.²⁶

C. GOVERNMENT'S RECOMMENDED AMENDMENTS TO THE FRANCHISING CODE

Some of the more notable recommendations in the Government's response to the Review Report are as follows:²⁷

1. the franchisor must provide a disclosure document to the franchisee if the franchisor notifies the franchisee of its intention to renew the franchise agreement in instances in which the franchisor must give at least six months' notice of its intention to either renew or not renew;

23. Alan Wein, *Discussion Paper: Review of the Franchising Code of Conduct* 5 (Commonwealth of Australia, Discussion Paper, Jan. 2013), available at <http://www.innovation.gov.au/smallbusiness/codesofconduct/Documents/2013ReviewDiscussionPaper.pdf>.

24. *Id.*

25. See ALAN WEIN, REVIEW OF THE FRANCHISING CODE OF CONDUCT viii – xi (Apr. 30, 2013), available at <http://www.innovation.gov.au/smallbusiness/codesofconduct/Documents/ReviewoftheFranchisingCodeofConduct.pdf>.

26. GOV'T OF AUSTR., *supra* note 19.

27. *Id.* at 7 – 17.

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2. a foreign franchisor or master franchisor will, in most cases, only be required to submit a short-form disclosure document to franchisees; foreign and master franchisors will have no obligation to annually update disclosure documents;
3. a franchisor must disclose the respective rights, and intended rights, of the franchisor and franchisee related to online sales;
4. franchisors must provide franchisees with a short summary of key risks;
5. subject to further consultation by the Government, franchisees may (i) terminate the franchise agreement in the event of a franchisor's insolvency and (ii) be recognized as unsecured creditors in the event of franchisor insolvency;
6. franchisors must (i) include a risk statement in their disclosure (including examples of potential unforeseen capital expenses) and (ii) demonstrate that significant capital expenditure is reasonable when it is not initially disclosed in the franchise agreement or disclosure document;
7. the administration of marketing funds must be transparent, funds must be separately accounted for, any marketing and advertising fund must be used only for expenses clearly disclosed to franchisees, an annual yearly audit must be conducted, and audit results must be made available to franchisees;
8. subject to further consultation by the Government, the Franchising Code will include an express obligation to act in "good faith";
9. a request from a franchisee to keep its details confidential and not disclosed as part of the disclosures usually made to prospective franchisees must come from the franchisee (thus, a franchisor cannot ask a franchisee if it wishes to keep its details confidential or provide in the franchise agreement that franchisor must keep these details confidential);
10. franchisors will be able to request certain information from an existing or current franchisee before they agree to a transfer or novation of a franchise agreement;
11. restrictions will be placed on the enforceability of restraint of trade clauses;
12. franchisors will be prevented from attributing legal costs of dispute resolution to a franchisee (unless ordered by a court) or requiring a franchisee to litigate in a jurisdiction other than the location in which the franchisee's business is principally conducted; and
13. civil pecuniary penalties will be authorized for violations, and the ACCC will be empowered to issue an infringement notice for a breach of the Franchising Code.

The Australian Government plans to implement the recommendations outlined in its response to the Review Report "as soon as feasible."²⁸ Further, the changes foreshadowed in the response will "only apply to franchise agreements entered into after the passage of legislation through Parliament."²⁹ This excludes changes to the enforcement regime; pecuniary penalties and infringement notices will be able to be sought by the ACCC for all breaches of the Franchising Code from a particular commencement date.

²⁸ *Id.* at 4.

²⁹ *Id.*

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D. CONCLUSION

The changes in 2013 may be just the beginning of significant reforms in Australia's franchise regime and related areas of manufacturing and distribution. The Government also accepted that an analysis of the impact of a minimum term and standard contractual terms for auto dealership arrangements applicable to car, boat, motorcycle, industrial equipment, or other "motor vehicle" dealer networks should be undertaken.

Further, on November 21, 2013, the State of New South Wales passed a Bill that included unfair contract provisions that will apply to motor vehicle dealership agreements³⁰ (such agreements are deemed franchise agreements in Australia and are therefore subject to the Franchising Code). The relevant parts of the Bill will extend uniform national unfair contract law provisions (which are currently limited to standard form consumer contracts) to the relationship between dealers and motor vehicle distributors in New South Wales. The Bill is awaiting assent from the Governor of New South Wales, at which time it will become law, and these particular provisions will commence once such assent is given. The unfair contract provisions of this Bill were enacted without consultation with motor vehicle distributors (franchisors) and amount to a concerning departure from the general push in Australia and by the federal government for consistent national regulation of both franchising and unfair contract laws. New South Wales will be the only state to have such legislation.³¹

Since the announcement of the Government's response to the Review Report, there has been a change of government in Australia. But the new Government has indicated in various public statements by the relevant Minister that it will continue to consult with industry in implementing the recommendations. At the time of this writing, no legislation has yet been introduced. Nevertheless, the recommendations in the response, if implemented, will inevitably lead to a series of significant changes to franchising regulation in Australia. These changes will require domestic and foreign franchisors to revisit their franchising systems and procedures and examine the terms of their franchise agreements to ensure compliance with the amended Franchising Code.

30. See Motor Dealers and Repairers Bill 2013 (New S. Wales) pt. 6 (Austl.), *available at* [http://www.parliament.nsw.gov.au/prod/parlment/nswbills.nsf/131a07fa4b8a041cca256e610012de17/7e87047706998291ca257c0d001a0a12/\\$FILE/b2013-014-d14-House.pdf](http://www.parliament.nsw.gov.au/prod/parlment/nswbills.nsf/131a07fa4b8a041cca256e610012de17/7e87047706998291ca257c0d001a0a12/$FILE/b2013-014-d14-House.pdf).

31. *Id.*

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